IN THE

Supreme Court of the United States

October Term, 1945

No. .....

JOHN KNUDSEN,

Petitioner and Appellee Below,

vs.

ARTHUR STEGMAN,

Respondent and Appellant Below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The Opinion Below.

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit is reported in 152 Federal Reporter (2d) 871. The opinion is also printed in full in the record [R. 284].

Jurisdiction.

The grounds and facts concerning jurisdiction are set forth in the foregoing petition.

Statement of the Case.

The district court found, with minor exceptions, the allegations of this petitioner's cross-petition to be true and found in part as follows:

> "That notwithstanding the facts aforesaid said Stegman, through his then attorney, represented and argued to said Superior Court in said cancellation proceeding in substance and effect that Knudsen had had his day in court in said bankruptcy proceeding No. 34,989-C, upon the fraudulent character of said Stegman's claim and that this court had determined that the judgments in said cause No. 363,482 and in said cause No. 432,034 were based upon such character of fraud as to make Stegman's said claim non-dischargeable notwithstanding Knudsen's discharge in bankruptcy; that the truth and the fact was that other than as hereinafter set forth this court at no time had or has ever considered the character of said claim, and this court never any time, except as hereinafter set forth, took any action with (213) reference thereto * * * That said representations of Stegman, and said arguments of his counsel, caused said Superior Court to make an extrinsic mistake of fact in that it caused said court to believe that Knudsen had had his day on said issue of fraud by the allowance of said claim in said bankruptcy proceeding in this court, and that said issue of fraud had thereby become finally established and had become *res judicata* by said action of this court; that said representations and arguments thereby caused said Superior Court in effect to refuse to take jurisdiction of said cancella-

tion proceeding and on said ground, by an order dated April 21, 1941, to deny Knudsen's said motion to cancel said judgments; that said mistake of fact so made by the said Superior Court deprived Knudsen in effect of any hearing at all upon the merits of his right to have said judgments and each of them cancelled [R. 198].

* * * * * * * * *

"That thereafter said petition for review came on for consideration before and by the Honorable Judge George Cosgrave as a judge of this court; that by reason of said representations as contained in said petition for review, the said judge was induced to commit an extrinsic mistake of fact, in that he was induced to believe that said Superior Court order of April 21, 1941, was a final judgment and adjudication on the merits that said claim was based on a direct fraud; that by reason of the said objections and representations of said Stegman as contained in (217) said petition for review and by reason of said extrinsic mistake of fact said judge made an order dated July 25, 1942, in said bankruptcy proceeding No. 34,989-C wherein and whereby he dissolved said injunction and terminated Knudsen's said proceedings for relief on the ground that the said order of said Superior Court dated April 21, 1941, was a final judgment on the merits concerning which this court 'should not and does not interfere'; that said order in substance and effect did constitute a refusal of this court to take jurisdiction on the merits of Knudsen's said proceeding for relief; that the said extrinsic mis-

take did thereby deprive Knudsen of his right to have his application for an injunction heard and considered upon the merits [R. 203]."

"That by reason of the aforesaid facts Knudsen has never at any time had his day in court, or any fair adversary hearing, or any hearing at all, upon the merits of his right to have said claim declared and decreed discharged by reason of his discharge in said bankruptcy; that by reason of the facts herein alleged said Stegman has prevented Knudsen from having a fair adversary hearing upon such question, and said Stegman has been the direct procuring cause of, and has been and is directly responsible for each of the extrinsic mistakes of facts herein set forth." [R. 203.]

"That by reason of the facts aforesaid there exist special and unusual circumstances of inequity, oppression and injustice to Knudsen, such as to invoke and impel the equitable jurisdiction of this court in granting equitable relief; that for this court not to disregard said Superior Court order of April 21, 1941, and not to disregard and vacate said orders of said referee, dated August 27, 1941, and said order of said judge dated July 25, 1942, would be inequitable and unjust." [R. 204.]

The aforesaid are some of the facts which the circuit court ignored but did not find unsupported by evidence.

As heretofore indicated, the facts of the case and the full extent of the oppression and inequity, which impelled the court to grant equitable relief can only be understood and fully appreciated by a reading of the entire findings of fact commencing at R. 194.

Summary of Argument.

Point I. A judgment in contract constitutes a waiver of fraud and is dischargeable in bankruptcy. *Tindle v. Birkett, supra.* Such a judgment is *res judicata* and a second order revealing upon its face that the court went behind the record of said original judgment and found the indebtedness based on fraud is void upon its face. *Cromwell v. Sac. County, supra.*

Since no court has the power to disregard said original judgment and determine the indebtedness based on fraud, also Judge Cosgrave had not the power to disregard said original judgment and declare said subsequent order *res judicata.* Judge Cosgrave's order which reveals upon its face that it is the subject of such a subsequent order, is therefore also void upon its face. In addition, it was the subject of a direct attack in the instant case.

To permit Judge Cosgrave or the circuit court to determine such subsequent order final and *res judicata* would be to permit them to accomplish by indirection that which they have not the power to accomplish directly.

The circuit court therefore has necessarily held in conflict with the aforesaid authorities holding that said original judgment in contract is *res judicata* and a bar to any subsequent judgment.

Point II. The circuit court appears to have believed immaterial the district court's findings that both of the subsequent orders should be disregarded by reason of extrinsic mistake of fact. It appears to have believed this

because Judge Cosgrave held the first subsequent order *res judicata* and that because Judge Cosgrave's order was unappealed from, therefore it also became *res judicata.* The findings concerning an extrinsic mistake of fact, however, are material findings because a court of equity in proper circumstances may on the ground of extrinsic mistake of fact set aside a judgment which is *res judicata. United States v. Throckmorton,* 98 U. S. 61, 25 L. Ed. 93.

The circuit court therefore set aside a material finding of fact without determining such finding improper or unsupported by evidence. This, an appellate court may not do. *Commissioner of Internal Revenue v. Scottish American Investment Co., supra.*

The circuit court deprived this petitioner of the equitable relief granted by the district court not only without determining no findings unsupported by evidence but without its making new findings or ordering a new trial, and without there appearing any justification for such procedure or that the circumstances were such as to permit a decision as a matter of law, or that questions of fact are not involved requiring further determination by the district or the circuit court, or that this petitioner might not have strengthened his case on another trial, or that justice does not require that the case need be remanded for further proceedings.

In so proceeding, the circuit court so far departed from the usual course of procedure as to justify the interposition of this court. *City of Hammond v. Schappi Bus Line,* 48 S. Ct. 66, 275 U. S. 164, 72 L. Ed. 218.

Errors Relied Upon.

1. The United States Circuit Court of Appeals erred, and held in conflict with applicable decisions of this court, and of another circuit court, in going beyond the record of a default judgment upon a promissory note and holding that two subsequent orders purporting to find fraud are valid and *res judicata.*

2. The circuit court erred, and departed from the usual course of judicial proceedings, in depriving this petitioner of the equitable relief granted by the district court without determining any of the findings of fact upon which such equitable relief was based to be unsupported by evidence, or without making new findings.

3. The circuit court also erred, and departed from the usual course of judicial proceedings, in reversing the district court in such circumstances without ordering a new trial.

ARGUMENT.

POINT I.

The Circuit Court of Appeals Erred, and Held in Conflict With Applicable Decisions of This Court, and of Other Circuit Courts, in Holding That After the Entry of a Judgment on Contract That a Court Subsequently Has the Power to Go Behind the Record of Such Judgment and Find It Based on Fraud and Not Dischargeable in Bankruptcy.

The district court expressly found and determined that said original default judgment in cause number 363482 constitutes a waiver of fraud and a final determination of the complete absence of fraud and is *res judicata* and that no court has the power to go behind the record in said cause and such a judgment [R. 200, 205]. It expressly found and determined that for said reason said two subsequent orders, directly attacked, are void and not *res judicata* [R. 200].

The circuit court nevertheless determined that said two subsequent orders, to-wit: an order made in said superior court cause number 432034 denying this petitioner's motion for injunctive relief, and an order thereafter made by Judge Cosgrave in the original bankruptcy proceeding denying this petitioner injunctive relief, each constitute a determination of the existence of fraud and are *res judicata*. The circuit court did this upon the theory that Judge Cosgrave determined that said superior court order

was valid, and that because this petitioner had not appealed from Judge Cosgrave's order said superior court order and Judge Cosgrave's order had become final and that therefore each of said subsequent orders are *res judicata* [R. 288].

By such determination the circuit court necessarily determined that a court may disregard a judgment which is *res judicata* and determine a subsequent judgment, based upon the same claim, to be *res judicata.* This the court may not do. *Cromwell v. Sac Co., supra.*

It would seem obvious that if the superior court in cause number 432034 had not the power to go behind the original default judgment in cause number 363482, then also Judge Cosgrave had not the power to determine the order in cause number 432034 to be a valid order, or otherwise he would be permitted to accomplish by indirection that which he has not the power to accomplish directly. His order, and said superior court order, therefore, are orders which did not become final by petitioner's failure to appeal. They are orders which, in so far as they purport to be adjudications at all, are void upon their face. They constitute, *upon their face,* an attempt to adjudicate again a matter which is already finally adjudicated. They were directly attacked upon this ground and the district court held in the affirmative of this issue [R. 205].

It would seem obvious that the circuit court also has not the power to hold that said order became final by

petitioner's failure to appeal or likewise it would be permitted to accomplish by indirection that which it has not the power to accomplish directly.

It is therefore obvious that in holding the order in said cause number 432034, and the order of Judge Cosgrave are *res judicata*, the circuit court necessarily has held that subsequent to the entry of a default judgment in contract, a court has the power to go outside of the record and find that the judgment is based on fraud and not dischargeable in bankruptcy.

The question is one of the power of a court to go behind a judgment which is *res judicata*.

We think that this court will not so hold and that the decision is in conflict with principles established by decisions of this court and of the United States Circuit Court of Appeals for the Eighth Circuit.

In *Tindle v. Birkett, supra* (citing *Crawford v. Burke*, 195 U. S. 176, 49 L. Ed. 147, 25 S. Ct. 9), this court held in effect that where the creditor stands upon the contract originally made, fraud is waived, and the claim is barred as a claim based on fraud and is therefore dischargeable in bankruptcy.

In *Cromwell v. Sac County, supra*, this court held that a previous judgment between the same parties, or their privies, is a conclusive adjudication of all questions both of law and fact determined by the court, not only as to every matter liquidated in the action, but as to every fact

which might have been liquidated and determined in the action.

In *Hart Steel Co. v. Railroad Supply Co.*, 244 U. S. 294, 37 S. Ct. 506, 61 L. Ed. 1148, the court stated:

> the "doctrine of *res judicata* is * * * a rule of fundamental and substantial justice, 'of public policy and of private peace,' which should be cordially regarded and enforced by the courts to the end that rights once established by the final judgment of a court of competent jurisdiction shall be recognized by those who are bound by it in every way, wherever the judgment is entitled to respect." (Citing *Kessler v. Eldred*, 206 U. S. 285, 51 L. Ed. 1065, 277 S. Ct. 611.)

It would seem the circuit court has violated the aforesaid rule. It has also violated the rule as similarly laid down in *Hagardine McKittrick Co. v. Hudson, supra.*

It appears the facts in the *Hagardine McKittrick* case are practically identical with those here. It would seem immaterial that Section 35 of the Bankruptcy Act, as now amended (11 U. S. C. 35), provides that the provable debts which are exempt from a discharge are: "*liabilities* (instead of a 'judgment') for obtaining property by false pretenses or false representations." The liability involved here is one which was reduced to a judgment in contract. The question here is a court's power to go behind a judgment which is *res judicata.* The change in the act obviously does not affect the applicability of the aforesaid decisions.

Notwithstanding the aforesaid decisions, and the obvious necessity for and the justice of such decisions, the decisions of the state courts seem quite unsettled.

In volume I of Collier's Bankruptcy, at page 1607, it is stated:

> "The cases are not at all clear regarding the question whether or not a suit on an implied in law contract constitutes a waiver of the tort and removes from the statutory exception the liability now merged in the judgment. One line of authority takes the position that where the suit is in contract there is a waiver of the tort, and the subsequent judgment obtained in the contract action is dischargeable even though the opposite result would have attended had the creditor sued in a tort action. Another line of authority holds that such view is not salutory * * *."

(Citing:)

FOR:

Scott v. Corn, 19 Am. B. R. (N. S.) 653, 660, 19 S. W. (2d) 412 (Tex. Civ. App.);

Speir v. Westmoreland, 40 Ga. App. 302, 14 Am. B. R. (N. S.) 543, 149 S. E. 422;

Aetna Casualty Co. v. Sentilles (La. Ct. App.), 29 Am. B. R. (N. S.) 316, 160 So. 149;

Marr v. Sup. Ct., 30 Cal. App. (2d) 275, 86 P. (2d) 141.

AGAINST:

Gehlen v. Patterson, 83 N. H. 328, 17 Am. B. R. (N. S.) 131, 141 Atl. 914.

The California courts recognize the applicability of this court's aforesaid decisions. In *Marr v. Superior Court, supra,* the appellate court expressly cited *Crawford v. Burke, supra,* and *Tindle v. Birkett, supra.*

If the decision herein were not squarely in conflict with the applicable decisions of this court, and of the circuit court, the question is one which in any event should be settled by this court. It is an important federal question which seriously affects a large number of bankrupt persons under the present bankruptcy practice. It is obvious that a finding of guilt of fraud, and that a man's debt can never be discharged in bankruptcy, very probably ruins his life and seriously affects the welfare of his family. The district court so determined, as have other courts.

It would seem obvious that the question of whether, after a man permits a default judgment to be taken against him on a promissory note, thereafter, and even years after the running of the statute of limitations, as in the instant case, a court can summarily, or in any manner at all, go behind such judgment and find him guilty of fraud and his debt non-dischargeable in bankruptcy, is one which ought to be clearly settled by this court, and certainly is one with which this court ought not to permit even the appearance of a conflict.

POINT II.

The Circuit Court of Appeals Erred, and Held in Conflict With Applicable Decisions of This Court, and of Other Circuit Courts, in Reversing the District Court in Complete Disregard of the Findings of Fact Determined by It to Justify Equitable Relief and Without Making New Findings or Determining Any of Such Findings Unsupported by Evidence, and Without Ordering a New Trial.

The circuit court recognizes in its opinion herein that the district court "held that neither the state court's decision nor Judge Cosgrave's decision was binding on it since both contained 'extrinsic mistakes of fact'" [R. 287]. This is of course an equitable defense. From the opinion it therefore appears that the district court deemed it proper to grant equitable relief. The facts upon which such equitable relief was granted, or of what the extrinsic mistakes of fact consist, are not stated. In any event not any of the findings of fact of the district court, whatever they may be, are determined to be unsupported by the evidence.

The circuit court however appears to have believed these unstated findings and these extrinsic mistakes of fact to be immaterial in view of its holding that since Judge Cosgrave determined that the state court had jurisdiction to determine the dischargeability of Stegman's judgment in cause number 432034, despite Knudsen's discharge in bankruptcy, and since his order was not appealed from, both the said state court order and Judge Cosgrave's order are now *res judicata.*

These findings of fact however are material. The trial court, sitting as a court of equity, had broad

jurisdiction to do equity and to meet the exigencies of a special case. *Pepper v. Lytton,* 308 U. S. 295; *Local Loan Co. v. Hunt,* 292 U. S. 234, 78 L. Ed. 1230; *Sims v. Jamison,* 67 F. (2d) 409. The circuit court overlooked the rule that a *final* judgment, *which is res judicata,* may be disregarded and set aside in equity in proper circumstances by reason of an extrinsic mistake of fact which caused a person to be deprived of a fair adversary hearing at law. 5 *Pomeroy Equity Jurisprudence* (24th Ed.), pp. 4671, 4672; *United States v. Throckmorton, supra.* And this is the well established law irrespective of the existence of fraud. In *Olivera v. Grace,* 19 Cal. (2d) 570, 122 P. (2d) 564, the statement of the court is so apt that we take the liberty of quoting it in part as follows:

> "Equity's jurisdiction to interfere with *final* judgments is based upon the absence of a fair, adversary trial in the original action. 'It was a settled doctrine of the equitable jurisdiction—and is still the subsisting doctrine except where it has been modified or abrogated by statute . . . that where the legal judgment was obtained or entered through fraud, mistake, or accident, or where the defendant in the action, having a valid legal defense on the merits, was prevented in any manner from maintaining it by fraud, mistake, or accident, * * * then a court of equity will interfere at his suit, * * *. The ground for the exercise of this jurisdiction is that there has been no fair adversary trial at law.' (5 Pomeroy, Equity Jurisprudence (Equitable Remedies (24 ed.),) pp. 4671, 4672.) Typical of the situations in which equity has interfered with final judgments are the cases where the lack of a fair adversary hearing in the original action is at-

> tributable to matters outside the issues adjudicated therein which prevented one party from presenting his case to the court. * * *." (Emphasis added.)

Attention should perhaps be called to the fact that the aforesaid extrinsic mistakes need not have been induced by fraud on the part of respondent. As stated in *Olivera v. Grace, supra.*

> "Some courts, it is true, have referred to this situation as 'constructive fraud' * * *. We think it more accurate, however, to characterize such a situation as extrinsic mistake, which is a recognized ground for the intervention of equity where the mistake has prevented a fair adversary hearing. * * * Thus, even if no actual fraud on the part of the defendant could be proved in the present action, the facts set forth are sufficient to justify the intervention of a court of equity * * *."

The statement of the circuit court that there is "nothing in the record which would justify any criticism of counsel for Stegman" is therefore immaterial [R. 288]. It never was contended by us, or found by the district court, that there was any wrong doing on the part of counsel. From the foregoing authorities it appears that it is sufficient that without wrongdoing, both the superior court and Judge Cosgrave were induced to make extrinsic mistakes of fact.

It would therefore appear that there can be no dispute but that the circuit court did not find any material findings of fact, unsupported by the evidence. Also, it would seem there can be no dispute but that the findings of fact support the judgment by reason of the existence of said extrinsic mistakes of fact alone.

It is therefore obvious that the circuit court reversed the judgment without determining that the material facts of the case as found by the trial court are unsupported by the evidence. This, an appellate court may not do. *Commissioner of Internal Revenue v. Scottish American Investment Co., supra,* holding that an appellate court's power is limited to a determination of whether the trial court's inferences and conclusions have any substantial basis in the evidence, and that if such basis exists "the process of judicial review is at an end."

Though *C. I. R. v. Scottish American Investment Co., supra,* directly involves the powers of review of the United States tax court, the opinion refers to the powers of an appellate court in general. This broad application appears to be proper, particularly since the adoption of rule 52, Rules of Civil Procedure. Irrespective of the scope which this court may have intended to be given to its decision, a circuit has already interpreted the decision as limiting the power of review of any court. *Gaytime Frock Co. v. Liberty Mutual Ins. Co.,* C. C. A. 7th, 148 F. (2d) 694, 696.

In the *Gaytime Frock Co.* case, *supra,* the court stated:

> "* * * the sole question here involved, revolves about the proprietary of the inferences and conclusions drawn from the evidence by the trial judge who had the primary function of finding the facts and choosing from among conflicting factual inferences those which he considered most reasonable. Our power is limited to a determination of whether those inferences and conclusions have any substantial basis

in the evidence. If such basis is present the process of judicial review is at an end. *CIR v. Scottish American Investment Co.*, 323 U. S. 119, 124, 65 S. Ct. 169, and the finding must be accepted by this court. *CIR v. Court Holding Co.*, 323 U. S. 702, 65 S. Ct. 707."

It would seem that the decision of the circuit court herein is in conflict with the aforesaid decision of the seventh circuit and that this conflict alone would be a sufficient justification for the interposition of this court.

Apart from Rule 52, it is the rule that even in an equity case an appellate court may not disturb findings of fact unless they are manifestly and clearly erroneous or wrong. *Rytex Co. v. Ryan*, C. C. A. Ill., 126 F. (2d) 952; *Cox v. Pabst Brewing Co.*, C. C. A. Kan., 128 F. (2d) 468.

By reason of the facts herein there is ample authority for the interposition of this court in *Mc Caugh v. Real Estate Land Title and Trust Co.*, 297 U. S. 606, 56 S. Ct. 604, 80 L. Ed. 879, wherein this court granted certiorari where a circuit court of appeals had exceeded its powers in weighing evidence.

On the face of the circuit court's opinion it appears that it followed a procedure by which this petitioner, without any proper justification therefor appearing in the opinion, was deprived of equitable relief granted by the district court without the making of new findings and without even ordering a new trial. This was done without it appearing that the circumstances are such as to permit a decision as a matter of law, or that questions of fact are not involved requiring further determination by the district or the circuit, or that this petitioner might

not have strengthened his case on another trial, or that justice does not require that the case need be remanded for further proceedings.

It would appear that to have reversed the case without ordering a new trial in such circumstances is definitely a departure so far from the usual procedure of a court of review as to require the supervision of this court. *City of Hammond v. Schappi Bus Line,* 48 S. Ct. 66, 275 U. S. 164, 72 L. Ed. 218; *Ferro Concrete Co. v. U. S.,* 112 F. (2d) 488, C. C. A. 1st; *American Derigold Corporation v. Derigold Metals Corp.* (C. C .A. Mich.), 104 F. (2d) 863.

Conclusion.

From the foregoing it would appear that the errors of the circuit court are of such general public concern as to justify the interposition of this court for each of the reasons stated in the petition.

Respectfully submitted,

WALTER H. MALONEY and
GEORGE ACRET,
Attorneys for Petitioner.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of April, A. D. 1946.

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